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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

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In the Matters of)
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Ameritech Corporation Telephone Operating)
Companies' Continuing Property Records Audit)
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Bell Atlantic (North) Telephone Companies')
Continuing Property Records Audit)
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Bell Atlantic (South) Telephone Companies')
Continuing Property Records Audit)
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BellSouth Telecommunications' Continuing)
Property Records Audit)
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Pacific Bell and Nevada Bell Telephone)
Companies' Continuing Property Records Audit)
)
Southwestern Bell Telephone Company's)
Continuing Property Records Audit)
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U S West Telephone Companies' Continuing)
Property Records Audit)
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CC Docket No. 99-117

ASD File No. 99-22

MCI WORLDCOM REPLY COMMENTS

MCI WORLDCOM, INC.

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October 25, 1999

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MCI WORLDCOM REPLY COMMENTS

I. Introduction and Summary

The Accounting Safeguards Division (ASD) audit reports provide a reliable basis for the Commission to initiate enforcement action. MCI WorldCom and other commenters demonstrate in their initial comments that the RBOCs' attacks on the audit procedures -- that the audit procedures were unduly restrictive or that the auditors failed to consider important evidence -- are without merit. The record shows that the auditors

gave the RBOCs every opportunity to find the sampled equipment, carefully considered all appropriate evidence, and reached conclusions that are valid in all respects.

The Commission should immediately initiate enforcement action to bring the RBOCs' accounting records into compliance with the Commission's rules and to correct the impact of RBOC plant overstatement on interstate rates. Contrary to the RBOCs' claims, the Commission's adoption of price cap regulation has not insulated the RBOCs' customers from the effects of overstated plant accounts. The CPR deficiencies confirmed by the ASD audits are longstanding, and thus had the effect of inflating the 1990-91 revenue requirements used to develop the RBOCs' initial price cap rates. By inflating the initial price cap rates, the RBOCs' CPR deficiencies have inflated all subsequent rates charged by the RBOCs, including their current rates. Unless the Commission corrects the RBOCs' rates by ordering an exogenous reduction in RBOC price cap indexes (PCIs), ratepayers will continue to bear the burden of overstated RBOC plant balances indefinitely.

The fact that the RBOC CPR deficiencies are longstanding is demonstrated by the sheer scale of the problems measured by the audits; these problems are so pronounced and prevalent as to make it highly unlikely that the errors developed in a relatively short period of time.¹ Moreover, federal and state regulators have had clear indications of problems with LEC CPRs for many years, since at least the early 1990s. By 1993, state regulators' concerns about deficiencies in LEC CPRs had developed to the point that NARUC adopted a resolution calling on the Commission to conduct

¹Bell Atlantic North Audit Report at ¶ 33.

comprehensive audits of LEC CPRs.² The 1997 ASD audits confirm federal and state regulators' longstanding concerns about RBOC CPR deficiencies, and also provide a statistically valid basis for regulators to estimate the magnitude of the plant overstatement that has resulted from these deficiencies.

The ASD audits demonstrate that the harm to ratepayers has been of stunning proportions. The estimated \$5 billion in missing equipment has caused overcharges of hundreds of millions of dollars per year in the interstate jurisdiction alone. Moreover, the \$5 billion in missing equipment found by the 1997 ASD audits represents only the tip of the iceberg. The ASD audits covered only the RBOCs' hard-wired Central Office Equipment (COE) investment, which represents only one-quarter of the investment on the RBOCs' books.

The Commission should immediately initiate enforcement proceedings by issuing an Order to Show Cause. The RBOCs should be required to reduce their price cap indexes (PCIs) to eliminate the effects of plant overstatement on the initial price cap rates. And, as recommended by the audit reports, the Commission should require the RBOCs to write off the missing investment from their COE accounts and bring their internal processes into compliance with the Commission's accounting rules.

²Letter from William E. Kennard, Chairman, FCC to Hon. Thomas J. Bliley, Jr., September 8, 1998, at 3.

II. The RBOC Audits Provide a Reliable Basis for Enforcement Action

As MCI WorldCom and other parties showed in their initial comments, the audit reports provide a reliable basis for the Commission to initiate enforcement action. The RBOC comments, which generally rehash the same meritless claims made in their January, 1999 responses to the audit reports, provide no reason to question the audit reports' fundamental conclusion -- that a substantial fraction of the equipment shown on the RBOCs' books is not used and useful in the provision of telecommunications service.

A. The Field Audit Procedures were Not Restrictive

Contrary to the RBOC claim that unduly "restrictive" field audit procedures have caused the auditors to overestimate the amount of missing equipment, the auditors gave the RBOCs every opportunity to find the sampled equipment items. First, the auditors gave the RBOCs ample advance warning of the central offices that would be visited, and gave the RBOCs the opportunity to assign the engineers most familiar with the COE in these offices to accompany the auditors.³ If the equipment was not found at the location specified in the CPR, the auditors gave the RBOC engineers an unlimited opportunity to locate the item anywhere in the central office.⁴ Thus, items were scored as "not found" only when the RBOC engineers most familiar with the central office were unable to find the item anywhere in the office.

³Bell Atlantic Audit Report at ¶ 18.

⁴Bell Atlantic North Audit Report at ¶ 8.

Furthermore, the ASD auditors gave the RBOCs more than sufficient time to find the sampled items. At each central office, the auditors were divided into two teams, each responsible for finding only 18 items over the course of a day -- items that, under the Commission's rules, must be capable of being "spot-checked."⁵ It was, moreover, the policy and practice of the ASD auditors to remain at the central office until the RBOC personnel themselves conceded that they were unable to find the missing items. There has never been any suggestion that the ASD auditors rushed the RBOCs or left the central office while the RBOCs were still searching for sample items.

Finally, as MCI WorldCom discussed in its initial comments, the "scoring" of the field inspections was far from "restrictive," and was, in fact, overly generous to the RBOCs.⁶ The scoring standards used by the auditors defined the "not found" category extremely narrowly; in practice, a CPR line item was classified as "not found" only when the auditors were shown no equipment at all.⁷ If the auditors were shown equipment, but it "could not be verified with certainty," the item was scored as "unverifiable" rather than "not found."⁸ The "unverifiable" items were, in turn, excluded from the auditors' calculation of the dollar value of missing equipment. As it is likely that a substantial portion of the items scored as "unverifiable" are, in fact, missing, the

⁵47 C.F.R. §32.2000(f)(5).

⁶MCI WorldCom Comments at 12-14.

⁷Bell Atlantic North Audit Report at ¶ 18 ("Items were considered not found only when the sampled equipment could not be located anywhere in the central office.")

⁸Bell Atlantic North Audit Report at ¶ 21.

audit reports' estimates of the dollar value of missing equipment should be viewed as conservative. Rather than causing the auditors to overestimate the amount of missing equipment, as the RBOCs claim, the audit procedures are likely to have resulted in the auditors underestimating the amount of missing equipment.

B. The RBOCs Have Provided No Reason for the Commission to Question the Auditors' Evaluation of the Rescoring Requests

Even though the field inspections were complete and comprehensive, and items were generally scored as "not found" only when the RBOCs' own personnel could not find the equipment, the ASD auditors nonetheless invited the RBOCs to submit additional evidence that might suggest reasons that the scoring should be changed.⁹ The ASD auditors recognized that there could be valid explanations, such as interim retirements, that would justify rescoring items that could not be found on the day of the audit.

In their comments, the RBOCs claim that their supplemental submissions provided sufficient evidence to "prove" that many of the items scored as "not found" during the field inspections actually exist.¹⁰ Because the ASD auditors only changed the scoring of a limited number of items for which the RBOCs submitted such "evidence," the RBOCs accuse the ASD auditors of having "ignored" their supplemental

⁹See Rescoring Public Notice at 2.

¹⁰See, e.g., Bell Atlantic Comments at 4.

submissions and failing to consider all appropriate evidence in reaching the audits' conclusions.¹¹

As MCI WorldCom showed in its initial comments, there is no basis for the RBOCs' accusation that the auditors "ignored" the rescoring requests.¹² The Bell Atlantic audit workpapers inspected by MCI WorldCom show clearly that the auditors examined all of Bell Atlantic's explanations and supporting documentation in detail, evaluated whether Bell Atlantic had provided an adequate and convincing explanation, and changed the scoring when warranted by the evidence.

There is a simple explanation for the relatively small number of scoring changes: the RBOCs simply failed to submit adequate and convincing justifications for their rescoring requests. For a significant number of items scored as "not found," the RBOCs admitted that the items did not exist.¹³ In other cases, the RBOC rescoring request's "explanation" actually confirmed the initial "not found" score. For example, if the RBOC stated that the item had not been located during the field inspection because it had been retired years earlier, this confirmed that the CPR line item did not correspond to equipment that was used and useful in the provision of telecommunications, and thus

¹¹See, e.g., Bell Atlantic Comments at 6.

¹²MCI WorldCom Comments at 10-11.

¹³See, e.g., BellSouth Response at 15 (Of the 116 items scored as "not found," BellSouth conceded that these scores were correct for 84 of the items. Further, for 16 of the 32 items for which BellSouth requested rescoring BellSouth suggested only that the items should be rescored to "unverifiable.")

was properly scored as “not found.”¹⁴ In other cases, the RBOC explanation was inconsistent with the audit team’s observations during the field inspection. And, finally, the RBOCs often provided documentation that did not support the explanation, provided source documentation that was inconsistent with their explanation, or failed to provide any source documentation at all.

The RBOCs’ contention that the auditors did not inform the RBOCs of the standard that would be used to evaluate the rescoring requests is absurd. The auditors specifically informed the RBOCs that any documentation submitted would have to be “adequate and convincing.”¹⁵ While the auditors placed no restrictions on the types of documentation that the RBOCs could submit in support of their rescoring requests, the Commission’s Part 32 rules specifically require companies to be able to support their CPR entries with original source documentation that must be maintained throughout the life of the property.¹⁶ That the RBOCs fully understood that rescoring requests would have to be supported by source documents is demonstrated by the fact that the RBOCs submitted invoices, telephone equipment orders, engineering drawings, and other source

¹⁴Rescoring Public Notice at 4 (“In some cases, carriers provided documentation that showed that a removal had taken place long before the audit work, such that the item should not have been listed on the CPR.”)

¹⁵Rescoring Public Notice at 2 (“Carriers were advised to provide adequate and convincing documentation that would make clear that the actual condition was different from what appeared to the auditor at the time of the physical inspection.”)

¹⁶47 C.F.R. §§ 32.12(b), 32.2000(e)(1), 32.2000(f)(8), 32.2000(e)(2).

documents of the type that the auditors found adequate and convincing.¹⁷ There is certainly no evidence that the RBOCs possess any source documents that would support their explanations, but have withheld them from the ASD auditors because of uncertainty about the rescoring standards.

Similarly absurd is the RBOCs' claim that the rescoring standard employed by the auditors was too stringent. Because the staff had actually visited the central offices to observe the sampled items, and the items could not be located even with the help of RBOC central office personnel, rescoring would have been inappropriate unless the supporting documentation was adequate and convincing. As is discussed in the Reply Affidavit of noted auditing expert Mr. James K. Loebbecke, attached to AT&T's Reply Comments in this proceeding, the auditors had performed an exhaustive search for the sampled items during the on-site inspections, and thus were properly skeptical when the RBOCs claimed, post-inspection, to have located a significant number of items at those very locations.¹⁸

In evaluating the RBOCs' rescoring requests, the ASD auditors exercised their professional judgement, drawing on their observations from the field inspections and their evaluation of the explanations and documentation provided by the RBOCs. Nothing in the RBOCs' comments provides any basis for the Commission to question

¹⁷See, e.g., Bell Atlantic Response at 4 ("In many cases these supplemental records, including invoices, telephone equipment orders (TEO), and property record input forms were used to develop an audit trail to locate and support the selected item.")

¹⁸Loebbecke Reply Affidavit at ¶ 18.

the auditors' judgments or simply accept, at face value, the RBOCs' claims that the equipment that for which they submitted rescoring requests does, in fact, exist.

C. The Commission Should Attach No Weight to the Audit Firms' Re-Audits

To support their claims that the FCC auditors' procedures were somehow deficient, several RBOCs have paid accounting firms to conduct "re-audits" of items that the ASD auditors scored as "not found."¹⁹ These "re-audits" suffer from a wide variety of shortcomings that make it impossible for the Commission to give them any weight at all.

As an initial matter, the accounting firms' "re-audits" were entirely one-sided. The accounting firms only looked for ways to adjust the "not found" scores in the RBOCs' favor; they did not examine the large population of "unverifiable" items to determine which of these items should more properly be scored as "not found."

Moreover, it is highly questionable whether the auditing firms' procedures are adequate to support the conclusions they have drawn. For example, Arthur Andersen's statement that its "testing should demonstrate that the ASD's audit results are flawed"²⁰ is based on a reinspection of only three U S West central offices in Colorado, apparently selected because they were the closest sample offices to Arthur Andersen's offices in Denver -- hardly a sufficient or statistically valid basis for dismissing ASD's audit

¹⁹Ameritech Comments at 14-15; U S West Comments at 19; BellSouth Comments at 22-23.

²⁰U S West Comments, Attachment 2 at 14.

procedures as “flawed.” Similarly, PricewaterhouseCoopers (PWC) only examined four of BellSouth’s offices; there is no indication of how PWC selected these offices or whether the items in these offices are in any way representative of the larger population of items scored as “not found” by the ASD auditors.

An additional problem with the “re-audit” procedures is that the accounting firms inspections clearly did not recreate the conditions of the ASD audits. In particular, the accounting firms conducted the reinspections for US West and BellSouth in mid-1999, almost two years after the ASD field inspections. During the two years since the ASD field inspections were conducted, the RBOCs have no doubt added a significant amount of equipment to the sampled central offices or moved equipment within these offices.

The most serious problem with the accounting firms’ “re-audits” is that the firms have provided insufficient documentation for the Commission to evaluate the procedures and scoring standards that were used; BellSouth and U S West, in particular, have provided none of the underlying documentation. That it is necessary to carefully scrutinize the procedures and scoring standards underlying the “re-audits” is demonstrated by the limited amount of source documentation that Ameritech has provided. As is discussed in the Loebbecke Reply Affidavit, this documentation “suggests that the discrepancies between the Staff’s and the accounting firms’ reports are based in large part on the accounting firms’ inappropriately generous rescoring standards.”²¹ For example, Arthur Andersen rescored an item from “not found” to

²¹Loebbecke Reply Affidavit at ¶ 36.

“found” despite the fact that the equipment item they were shown by Ameritech was of a much older vintage than the 1992 vintage shown in the CPR listing.²²

The limited summary that has been provided of Arthur Andersen’s “re-audit” of U S West’s central offices raises further questions concerning the accounting firms’ rescoring standards. In its comments, U S West claims that Arthur Andersen’s results “contradict the ASD’s claims with respect to the level of error in U S West’s continuing property records.”²³ But closer examination of Arthur Andersen’s summary of its work shows that Arthur Andersen did not count as “not found” (1) eight items that had been “retired” by U S West because neither the ASD auditors nor U S West had been able to find the items during ASD’s field inspection; and (2) three items that Arthur Andersen could not find but argued should have been excluded from the sample because they were “mobile” items.²⁴ The exclusion of the “mobile” items from Arthur Andersen’s sample was improper: whether mobile or not, the Commission’s property record rules require the LEC to be able to demonstrate the existence of all property record items.²⁵

To a great extent, the accounting firms’ reinspections actually confirm the reliability of the ASD audit procedures. For example, despite extremely generous and, in many cases, questionable scoring, Arthur Andersen confirmed the auditors’ “not

²²Id.

²³U S West Comments at 19.

²⁴U S West Comments, Attachment 2 at 14.

²⁵47 C.F.R. 32.2000(f)(5).

found” score for 108 of the 140 Ameritech items scored as “not found.”²⁶ Similarly, of the 20 U S West items it examined, even Arthur Andersen claims to have found only five.²⁷

D. There Was No Reason to Conduct a “Two-way” Audit

In their comments, the RBOCs repeat their argument that the auditors should have conducted a “two-way” audit in which, in addition to testing for the existence of CPR line items, the auditors would also have tested for in-service equipment that the RBOCs had neglected to record on their books. In their September 22, 1999 letter to the Commission, the accounting firms go so far as to describe the audit procedures as “severely biased” because a two-way audit was not performed.²⁸

Contrary to the accounting firms’ claim, the audits were not “biased” in any way by the auditors’ decision to conduct a two-way audit. Whatever the merits of a two-way audit in other audit settings, the ASD auditors had no reason to conduct a two-way audit. Because ratepayers are harmed only if a LEC has equipment on its books that is not associated with equipment used and useful in the provision of telecommunications service, regulators’ sole obligation is to ensure that all equipment that is recorded on the LEC’s books is in fact used and useful in the provision of telecommunications service.

²⁶Ameritech Response, Appendix A-0, at 5.

²⁷U S West Comments, Attachment 2 at 14.

²⁸Letter from Carl R. Geppert, Arthur Andersen, T. J. Mangold, PricewaterhouseCoopers, John W. Putnam, Ernst & Young, to Magalie R. Salas, FCC, September 22, 1999, at 1 (Joint Accounting Firms Letter).

It should be of no concern to the regulator if a LEC neglects to record an equipment item on its books. The LEC is at all times free to conduct inventories and, if it discovers any unrecorded items, to add these items to its books.

Consistent with the Commission's regulatory responsibilities, the auditors established their objective as "determin[ing] whether [the RBOC's] reported investment in COE represents property used and useful in the provision of telecommunications services."²⁹ Given this objective, the auditors properly designed their audit to test only for the existence of equipment items shown on the CPR. The existence of any items that the RBOCs had neglected to record on their books was irrelevant to the audit objectives and the Commission's regulatory responsibilities.

There is, any event, no reason to believe that the amount of equipment that the RBOCs have neglected to record on their books is significant. Every inventory ever conducted by a LEC has found that plant "overstatement" far outweighs any "understatement."³⁰ This is hardly surprising, given that the LECs have every incentive to ensure that all investments are recorded, but no incentive to ensure that retirements are properly recorded or otherwise ensure that the books are not overstated.

E. The Sample Design Produces Valid Statistical Extrapolations

The RBOCs and their accounting firms charge that the sample design used by the ASD auditors does not allow valid extrapolations to the value of missing equipment in

²⁹Bell Atlantic North Audit Report at ¶ 1 (emphasis added).

³⁰See MCI WorldCom Comments at 8.

the population. For example, the accounting firms argue in their September 22, 1999 letter that “[i]t is not possible nor is it appropriate to reach any conclusion regarding a dollar value using the sampling methodology chosen by the FCC staff.”³¹ This is, allegedly, because “the FCC staff designed and performed a test of compliance with the CPR Rules, not one designed to assess the accuracy of COE plant balances.”³²

The claim that the sample design is useful only for testing “compliance,” i.e., the percentage of missing items in the population, but not for estimating dollar values, is without merit. While alternative sample designs may have produced a relatively smaller confidence interval for the dollar value of missing equipment, it is nonetheless both possible and appropriate to use the auditors’ sample design to estimate the dollar value of missing items. As is discussed in the Reply Affidavit of sampling expert Dr. Robert M. Bell, attached to AT&T’s Reply Comments, the sample design used by the staff “produced essentially unbiased point estimates for both the percentage of missing items and the total dollar value of missing equipment.”³³

In fact, the RBOCs implicitly concede that the sample design can be used to estimate the dollar value of missing items. Despite all of their complaining about the sample design, none of the RBOCs has seriously questioned the auditors’ calculations of

³¹Joint Accounting Firms Letter at 2.

³²Id.

³³Bell Reply Affidavit at ¶ 12.

the estimated dollar value of missing items.³⁴ These calculations, shown in Appendix B of the Audit Reports, use standard formulas found in any statistics textbook.³⁵ And, these calculations show that the magnitude of the plant overstatement -- over \$5 billion - - has been such that the harm to ratepayers has been substantial.

III. Plant Overstatements Have Inflated Interstate and Intrastate Rates

The RBOCs' deficient CPR practices have inflated the RBOCs' interstate and intrastate rates. Overstated plant balances have inflated RBOC revenue requirements for many years, including the projected 1990-91 revenue requirements used to initialize the Commission's price cap plan. Because the initial price cap rates were inflated, all interstate rates charged by the RBOCs under price cap regulation, including their current rates, have been inflated as well.

A. Plant Overstatements Inflate Revenue Requirements

As MCI WorldCom demonstrated in its initial comments, plant overstatements have inflated the RBOCs' rates by inflating their revenue requirements. The precise effect of plant overstatements on revenue requirements depends on whether the overstated investment is not associated with assets acquired and placed in service or whether the overstated investment represents a failure to record retirements. If the

³⁴The only issue raised by the RBOCs is that the estimator is not mathematically unbiased, but they quickly come to the conclusion that any bias is negligible. See Bell Atlantic Response, Appendix A, at 11.

³⁵AT&T Comments, Affidavit of Robert M. Bell at ¶ 27.

investment is not associated with assets acquired and placed in service, then the overstated investment has inflated both the rate base and depreciation expense. If the overstated investment represents omitted retirements, then the overstated investment has inflated depreciation expense but has had no effect on the rate base.

In their comments, the RBOCs continue to claim that overstated plant balances have no effect on a company's revenue requirement. They argue, first, that CPR deficiencies can have no effect on a company's revenue requirement because USOA accounts, not CPR records, are used to develop the revenue requirement.³⁶ While it is true that revenue requirements are computed using USOA account balances, it is also irrelevant. Because the Commission's rules require the LECs to reconcile their USOA accounts and CPR records every year,³⁷ any overstatement of the CPR records will cause the USOA account balances to be overstated as well.

The RBOCs also continue to claim that the missing equipment consists solely of omitted retirements and, thus, that the rate base has not been inflated. In fact, the RBOCs argue that "it is even improper for the auditors to present even an implication that the assets may not have been placed in service."³⁸ But there is no basis for the Commission to assume that the missing equipment consists solely of omitted retirements. None of the RBOCs has been able to provide sufficient and convincing documentation for the acquisition of the assets in question and for their placement into

³⁶See, e.g., Bell Atlantic Comments at 8.

³⁷47 C.F.R. § 32.2000(e)(2)(iii).

³⁸BellSouth Comments at 27.

regulated accounts,³⁹ despite the fact that the Commission's rules require the RBOCs to maintain such documentation.

Finally, there is no merit to the RBOC claim that depreciation expense is unaffected by plant overstatements. MCI WorldCom showed in its initial comments that the RBOC claim that remaining life depreciation "self-corrects" for plant overstatement by reducing the depreciation rate is based on an incorrect assumption about the vintages of the omitted retirements. The Snively King Report, attached to MCI WorldCom's initial comments, showed why the RBOCs' assumption is incorrect and demonstrates that omitted retirements would in fact be expected to have no effect on the depreciation rate.⁴⁰ Thus, inflated gross plant resulting from omitted retirements has translated directly into inflated depreciation expense and, consequently, inflated RBOC revenue requirements.

B. Inflated Revenue Requirements Inflated the Initial Price Cap Rates

By inflating the RBOCs' revenue requirements, the RBOCs' plant overstatements have inflated both intrastate and interstate rates. In the jurisdictions that have continued to use rate of return regulation, there has been a direct link between the RBOCs' revenue requirement and their rates. In the jurisdictions that have adopted price cap regulation, inflated RBOC revenue requirements have inflated the RBOCs' initial price cap rates and, thus, every subsequent rate charged under price cap regulation.

³⁹Bell Atlantic North Audit Report at ¶¶ 26, 30, 38.

⁴⁰Snively King Report at 8-9.

Contrary to the RBOC claim that the ASD audits cannot be used to draw conclusions about the July 1, 1990 rates used to initialize the Commission's price cap plan, all evidence indicates that the deficient CPR practices confirmed by the 1997 audits are longstanding. First, as discussed in the audit reports, the very large number of incorrect CPR line items could not have been generated overnight.⁴¹ Undetailed investment, in particular, has been a serious problem for many years.

Second, state and federal regulators have been concerned about problems with LEC CPRs for many years. The ASD audits are not a mere "snapshot" of the state of the RBOCs' CPRs in 1997; they are, instead, the latest in an ongoing effort by federal and state regulators to investigate deficiencies in LEC CPRs that have been apparent since at least the early 1990s. In 1991-92, for example, a District of Columbia Public Service Commission staff investigation of "undetailed investment" and other problems with Bell Atlantic-D.C.'s CPR resulted in significant writeoffs and rate reductions.⁴² In 1993, growing concern among state regulators about the accuracy of LEC CPRs led NARUC to adopt a resolution calling on the Commission to audit LEC CPRs.⁴³ In 1994, preliminary FCC audits of the RBOCs' CPRs found deficiencies similar to those found by the D.C. PSC's investigations of Bell Atlantic-D.C.⁴⁴ In 1995, a joint federal-state

⁴¹Bell Atlantic Audit Report at ¶¶ 33-35.

⁴²Chesapeake & Potomac Telephone Company, Formal Case No. 926, Order No. 10353, 148 P.U.R. 4th 113, 187 (1993).

⁴³Letter from William E. Kennard, Chairman, FCC to Hon. Thomas J. Bliley, Jr., Chairman, House Committee on Commerce, September 4, 1998, at 3.

⁴⁴Bell Atlantic North Audit Report at ¶¶ 11-12.

audit team found “substantial deficiencies” in GTE’s property records.⁴⁵ Given this history, it is clear that the CPR deficiencies described in the ASD audit reports are longstanding.

The significance of the 1997 audits is not only that they confirm concerns that regulators have had for many years -- that the RBOCs do not maintain their CPRs in accordance with the Commission’s rules -- but that they provide, for the first time, a statistically valid estimate of the plant overstatement that has resulted from these CPR deficiencies. Given that the auditors have estimated that over \$5 billion in hard-wired COE is missing, and that hard-wired COE represents only one-quarter of the RBOCs’ plant investment, the total amount of plant overstatement that will be found when the Commission has completed the remaining phases of its CPR audits is likely to reach truly staggering levels. Longstanding plant overstatements of this magnitude have clearly had a material impact on the level of the RBOCs’ intrastate and interstate rates.

IV. The Commission Should Take Immediate Enforcement Action

The ASD audits of the RBOCs’ CPRs provide a reliable basis for the Commission to enforcement action. All aspects of the audits, including the sample design, field inspection procedures, and evaluation of the RBOCs’ rescoring requests, were planned and conducted in a professional manner, consistent with all applicable auditing standards. The audit reports provide reliable, if conservative, estimates of the

⁴⁵GTE Telephone Operating Companies; Release of Information Obtained During Joint Audit, Memorandum Opinion and Order, 13 FCC Rcd 9179 (1998).

amount of investment that is not associated with equipment used and useful in the provision of telecommunications service.

Immediate enforcement action is necessary because the plant overstatements identified by the audit reports have inflated the RBOCs' interstate and intrastate rates and have made it impossible for the Commission and state regulators to rely on the RBOCs' plant accounts for any regulatory purpose. The Commission should first require the RBOCs to reduce their price cap indexes (PCIs) to eliminate the effects of plant overstatement on the initial price cap rates. The audit reports' estimates of the amount of missing equipment demonstrate that the RBOCs have overcharged interstate ratepayers by hundreds of millions of dollars each year and will continue to do so unless price cap adjustments are made immediately. The estimated plant overstatements shown in the audit reports provide a statistically valid basis for the Commission to estimate the amount of the necessary price cap adjustment.

At the same time, the Commission should order the RBOCs to write off the estimated missing investment from their COE accounts and bring their internal processes into compliance with the Commission's accounting rules. Final adjustments to the plant balances can be made when the RBOCs have completed the comprehensive inventories recommended by the audit reports.

V. Conclusion

For the reasons stated herein, the Commission should initiate enforcement proceedings against the RBOCs based on the findings contained in the ASD audit reports.

Respectfully submitted,
MCI WORLDCOM, INC.

A handwritten signature in black ink, appearing to read "Alan Buzacott". The signature is fluid and cursive, with the first name "Alan" and last name "Buzacott" clearly distinguishable.

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October 25, 1999

STATEMENT OF VERIFICATION

I have read the foregoing, and to the best of my knowledge, information, and belief there is good ground to support it, and that it is not interposed for delay. I verify under penalty of perjury that the foregoing is true and correct. Executed on October 25, 1999.



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CERTIFICATE OF SERVICE

I, Vivian I. Lee, do hereby certify that copies of the foregoing Reply Comments were sent via first class mail, postage paid, to the following on this 25th day of October, 1999.

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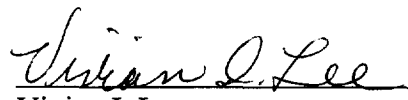
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